



**State of California  
Department of Housing and Community Development**

**AB 1699 Portfolio Restructuring Guidelines  
Sections 100 through 115**

**Final Statement of Reasons**

**Introduction**

On September 5, 2013, the California Department of Housing and Community Development (hereinafter “the Department”) released for public comment guidelines required by Health and Safety Code Section 50560(h). These guidelines implement and interpret the provisions of AB 1699 of 2012.

Comments on the initial proposed guidelines were received during a public comment period extending from September 5, 2013 to October 4, 2013. Public hearings were held on September 24, 2013 in Van Nuys and on September 27, 2013 in Sacramento.

On March 26, 2014, the Department released for public comment a second draft of the proposed guidelines, with changes shown in strike-out underline format, along with a document summarizing and responding to each comment made on the initial proposed guidelines. Written comments on the second draft were received during a comment period extending from March 26, 2014 to April 11, 2014; no public hearing were held.

On July 17, 2014, the Department released for public comment a third draft of the proposed guidelines, with changes shown in strike-out underline format, along with a document summarizing and responding to each comment made on the second draft. Written comments on the third draft were received during a comment period extending from July 17, 2014 to August 6, 2014; no public hearings were held.

This Final Statement of Reasons responds to comments received during the last public comment period. No further changes are proposed in response to these comments. The Department is adopting the guidelines as proposed in the third draft, with a small number of editorial revisions (correction of several erroneous section references and capitalization errors, etc.)

### **Summaries of and Responses to Public Comments On 3<sup>rd</sup> Draft AB 1699 HCD Loan Restructuring Guidelines**

<b>Commentator Short Name</b>	<b>Commenter</b>
Klein	Robert Klein, Klein Financial Corporation, 550 S California Ave., Suite 330, Palo Alto, CA 94306, telephone 650.833.0100
LTSC	Takao Suzuki, Little Tokyo Service Center, 231 East Third St., Suite G106, Los Angeles, CA 90013, telephone 213.473.3030
CHPC	Diep Do, California Housing Partnership Corporation, 369 Pine Street, Suite 300, San Francisco CA 94104, telephone 415.433.6804
Western Center	Brian Augusta, Western Center for Law & Poverty, 1107 Ninth Street, Suite 700, Sacramento, CA 95814, telephone 916.282.5103

Below are summaries of comments received, and HCD's response.

<b>Comment</b>	<b>Response</b>
<b>Section 104 Requirements Pertaining to All Projects Restructured under this Chapter</b>	
<b>Section 104(c)</b>	
Western Center: Grant third-party beneficiary status to new tenants, as well as to existing ones.	As previously noted, HCD is not aware of instances where third-party beneficiary rights have had beneficial impacts under its programs, and has some level of concern about them being used inappropriately, especially given the complexity of these guidelines. Because this issue has relevance beyond these guidelines, HCD would be interested in any information that is available about the practical impact of conferring third party beneficiary status, in other situations. At this point, no change is proposed.

Comment	Response
<b>Section 105 Requirements for Projects being Refinanced and/or Syndicated</b>	
<b>Section 105(d)</b>	
Klein: The referenced requirements for senior debt conflicts with current market practice. See comments on 107(b), (d) and (f) for specifics.	See response to comments on Section 107.
<b>Section 106 Conditions on Subordination to Senior Loans</b>	
<b>Section 106(b)(2)</b>	
Klein: Allow repayment of general partners loans even if there is a Special Rent Increase, to provide incentive for sponsors to keep projects afloat.	<p>Current program rules, as well as the proposed guidelines, allow for repayment of general partner loans out of sponsor distributions and developer fee earned in connection with rehabilitation.</p> <p>As noted in responses to comments on previous drafts of these guidelines, the intent of the authorizing statute is to facilitate necessary rehabilitation while keeping rents as low as possible, not to make developers whole. Accordingly, the guidelines sharply limit the extent to which owners may receive compensation beyond developer fees and distributions, including compensation for past contributions to their projects. HCD 's experience suggests that this arrangement does not result in developers abandoning troubled projects.</p> <p>With regard to this particular subsection, which is limited to conditions under which HCD may subordinate to senior debt, the statute (section 50560(g)) does not permit adding to the amount of existing senior debt, except for the purpose of covering rehabilitation costs. In addition, the statute (section 50560(f)) restricts HCD from subordinating to a loan that exceeds the amount required to increase feasibility and to fund reasonable rehabilitation, if Special Rent Increases are being imposed. Therefore, no repayments of general partner loans are permitted, except out of developer fees and distributions. if there are Special Rent Increases being imposed. No change is being made to this</p>

Comment	Response
	section.
Klein: Allow limited partner buyout costs to be eligible for inclusion in project costs, where there is a Special Rent Increase. Not doing this would reduce equity contributions in 9% projects.	Same response as above. Limited partner buy-out costs are not costs directly tied to rehabilitation, and Special Rent Increases are permitted under the statute only to the extent necessary to facilitate rehabilitation.
Klein: Allow profit on sale, at the end of the regulatory period, to incentivize good maintenance.	<p>The guidelines do not limit profit from sales after the regulatory period. They do limit this type of profit during the regulatory period, including any extensions.</p> <p>In projects with below-market rents, there will always be some level of incentive to scrimp on maintenance in order to maximize cash flow. This makes it important to have funding agency inspections, budget reviews, and similar preventative measures.</p> <p>Allowing a profit on sale during the regulatory period might have some positive impact on maintenance, but HCD is doubtful that it would typically be very significant. As a matter of policy, it has prohibited this source of profit for some time, and not observed adverse consequences. On the other hand, allowing a Special Rent Increase for the purpose of enabling a sales profit, or allowing additional hard debt financing for this purpose, would have clear negative consequences. No change is proposed.</p>
Klein: Allow profit on sale, to encourage lending by creditors related to the owner, and to discourage them from foreclosing or taking other actions that could be detrimental to the project.	The current draft guidelines would allow refinancing of existing secured debt that had been approved by the department, and allow other debt to be repaid out of developer fee and sponsor distributions. HCD does not believe this arrangement serves as an impediment to obtaining necessary project funding. No change is proposed.
<b>Section 107 Requirements for Senior Loans</b>	
<b>Section 107(b)</b>	
Klein: Why prohibit call options for senior debt, except in case of default? This prevents the sponsor from refinancing, prior to the maturity date, and forces use of loans with higher interest rates.	For the last decade, HCD has generally required senior loans to be fully amortized, due to the significant risk associated with other structures. HCD remains concerned with this risk, but recognizes

Comment	Response
	that market conditions may result in the costs of fully amortized loans outweighing the risks, at least in some cases. For this reason, and in subsection 107(g), it is proposing to give itself the latitude to make exceptions, on a case-by-case basis.
<b>Section 107(d)</b>	
Klein: Requiring a cap on interest rates, where they are not fixed, increases needed subsidy, reduces the number of projects that can be reached, and potentially forces higher tenant rents. Why is this proposed?	As noted in the response to the comment on subsection 107(b), HCD is proposing to give itself some flexibility on this point. That said, it has applied this rule to new projects for quite some time, and has closed a number of projects with acceptable rate caps where the initial rate was highly competitive.
<b>Section 107(f)</b>	
Klein: What are the terms and conditions acceptable to HCD for swaps, collars, and similar provisions of senior debt?	HCD has been able to successfully negotiate these terms on large numbers of senior loans, and would happy to arrange for a conversation about specific provisions, in the context of a specific project. No guideline change is proposed.
<b>Section 108 Rent Restrictions for Assisted Units</b>	
<b>Section 108(b)(3)</b>	
LTSC: The level of rehab required to qualify for a Special Rent Increase should be reduced to \$20,000 per unit for work. Also, if the HCD-assisted project is being combined with non-HCD projects, this requirement should only apply to the original HCD-assisted property.	<p>The statute directs HCD to use TCAC's standard in this area. As TCAC no longer uses the \$20,000 figure suggested by the commenter, HCD believes that use of this figure is problematic.</p> <p>As to how this standard is applied to combined projects, the rules on Special Rent Increases only pertain to HCD-assisted units, so HCD's initial thought is that the minimum rehab standard should apply only to them. No change is necessary to apply the rule in this manner.</p>
<b>Section 108(b)(4)(A)(viii)</b>	
Klein: Limiting developer fee for projects requiring an Early Special Rent Increase will discourage developers from taking on the tougher projects,	The noted restriction on developer fee applies only to cases where there is significant delay between the time Special Rent Increases

<b>Comment</b>	<b>Response</b>
especially for-profits, who are often more efficient.	begin and the time rehabilitation commences, and likely very large rent increases. In these cases, HCD believes that the bulk of its developers will not be deterred from addressing serious problems with projects that they already own, due to the inability to receive the maximum possible developer fee. No change is proposed.
<b>Section 108(c)</b>	
Klein: Allow flexibility for Special Rent Increases not anticipated at construction loan closing but needed to meet senior lender requirements at conversion, without penalizing developers by cutting their developer fee in half.	State housing programs generally hold developers to the rent levels promised at the time of construction loan closing, and expect senior lender requirements to be met through means other than adjusting these rent levels. HCD sees no reason to deviate from this practice, and is not proposing a change.
Western Center: We support the most recent changes made to this subsection, and urge no further changes.	No further changes have been made.
<b>Section 112 Underwriting Requirements</b>	
<b>Section 112(b)</b>	
Klein: When evaluating commercial vacancy history, take into account purposeful holding of space vacant in anticipation of planned rehabilitation.	Agreed, HCD's review of project operating history needs to take this type of action into account; projections based on the most recent period may need adjustment. No guideline change is needed to permit adjustments of this nature.
<b>Section 112(c)</b>	
Section 112(c)	
Klein: Specify that operating expense projections should "eliminate electrical operating costs that are produced by project-based solar."	HCD agrees that operating expense projections should reflect savings from existing solar installations, or from those included in the proposed scope of rehab. Because there are numerous similar improvements that should also be taken into account, the proposed guideline is written generally, and does not attempt to list each one. No change is proposed.
<b>Section 112(h)</b>	
Klein: Allow repayment of general partners loans even if there is a Special Rent Increase, to provide incentive for sponsors to keep projects afloat.	See response to identical comment on Section 106(b)(2).

Comment	Response
Klein: Allow limited partner buyout costs to be eligible for inclusion in the project costs, where there is a Special Rent Increase. Not doing this would reduce equity contributions in 9% projects.	See response to identical comment on Section 106(b)(2).
Klein: Allow profit on sale, to incentivize good maintenance.	<p>In projects with below-market rents, there will always be some level of incentive to scrimp on maintenance in order to maximize cash flow. This makes it important to have funding agency inspections, budget reviews, and similar preventative measures.</p> <p>Allowing a profit on sale might have some positive impact on maintenance, but HCD is doubtful that it would typically be very significant. As a matter of policy, it has prohibited this source of profit for some time, and not observed adverse consequences. On the other hand, allowing a Special Rent Increase for the purpose of enabling a sales profit, or allowing additional hard debt financing for this purpose, would have clear negative consequences. No change is proposed.</p>
<b>Section 113 Department Fees</b>	
<b>Section 113 (b)</b>	
Klein: The annual monitoring fee for project with over 60 units is excessive, and appears to be increased to allow non-performing projects to pay less. This arrangement penalizes the best performing projects, which tend to have low monitoring costs, and rewards non-performing projects, which tend to have high costs.	The proposed fees are indeed higher than they would otherwise be, to permit HCD to defer or waive them for projects that cannot afford them. They are not calibrated to the costs of monitoring individual projects, but rather based generally on ability to pay, coupled with the cost of monitoring the overall portfolio. HCD believes this structure will enable more projects to undergo recapitalization, and is fairer than a formula based entirely on the monitoring costs associated with individual projects. It doubts that the magnitude of the fees are large enough to induce undesired sponsor behavior, such as purposely running operating deficits. No change is proposed.

#### Determination Regarding Local Mandates

Pursuant to Government Code Subsection 11346.9(a)(2), the Department had determined that these guidelines do not impose a mandate upon local agencies/school districts.

#### Determination Regarding Alternatives

Pursuant to Government Code Subsection 11346.9(a)(4), the Department had determined that no reasonable alternative considered by the agency or that has otherwise been identified and brought to the attention of the agency would be more effective, as effective and less burdensome, or more cost effective. (Government Code 11346.9(a)(4)).